Supreme Court, U.S.
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In The

Supreme Court of the United States

WALTER H. ANNENBERG, as SOLE TRUSTEE of the TRUST UNDER WILL OF MOSES L. ANNENBERG, WALTER H. ANNENBERG and LEONORE ANNENBERG,

Petitioners,

v.

BOARD OF COMMISSIONERS OF THE COUNTY OF MONTGOMERY, ET AL.,

Respondents.

On Petition For Writ Of Certiorari To The Supreme Court Of Pennsylvania

BRIEF FOR THE RESPONDENTS BOARD OF COMMISSIONERS OF THE COUNTY OF MONTGOMERY, ET AL. IN OPPOSITION

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COUNTER-STATEMENT OF QUESTIONS PRESENTED

1. Whether the Supreme Court of Pennsylvania's remand to the County of Montgomery to remedy a discriminatory tax scheme is consistent with federal due process required by the Fourteenth Amendment.

2. Whether the Supreme Court of Pennsylvania correctly held that the United States Supreme Court's decision in *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, Fla. Dept. of Business Regulation*, 496 U.S. 18 (1990) provides a taxing authority with flexibility in curing a discriminatory tax scheme.

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES iii

OPINIONS 1

JURISDICTION 1

COUNTER-STATEMENT OF CASE 1

ARGUMENT 6

A. THE SUPREME COURT OF PENNSYLVANIA'S RULING THAT RESPONDENTS ARE RESPONSIBLE FOR PROVIDING PETITIONERS WITH A REMEDY CONSISTENT WITH *McKESSON* DOES NOT VIOLATE THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT 7

B. THE SUPREME COURT OF PENNSYLVANIA CORRECTLY HELD THAT *McKESSON* PROVIDES A TAXING AUTHORITY WITH FLEXIBILITY IN CURING A DISCRIMINATORY TAX SCHEME 11

CONCLUSION 18

TABLE OF AUTHORITIES

Page

CASES

Annenberg, et al. v. The Commonwealth of Pennsylvania, et al., 2000 WL 718216 1

Associated Indus. v. Lohman, 511 U.S. 641 (1994) ...12, 14

Commonwealth v. Budd Co., 108 A.2d 563 (Pa. 1954), *appeal dismissed*, 349 U.S. 935 (1955) 10

Davis v. Michigan Department of Treasury, 489 U.S. 803 (1989) 15

Dryden v. Madison County, 522 U.S. 1145 (1998) 12

Fisher Controls Co., Inc. v. Commonwealth, 381 A.2d 1253 (Pa. 1977) 10

Fulton Corp. v. Faulkner, 516 U.S. 325 (1996) 1, 3, 15

Garofolo, et al. v. Commonwealth, 648 A.2d 1329 (Pa. Cmwlth), *appeal dismissed*, 659 A.2d 561 (1994) 10

Harper v. Virginia Department of Taxation, 509 U.S. 86 (1993) 14, 15

McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, Fla. Dept. of Business Regulation, 496 U.S. 18 (1990) ..... *passim*

Newsweek, Inc. v. Fla. Dept. of Revenue, et al., 522 U.S. 442 (1998) 11, 12

Reich v. Collins, 513 U.S. 106 (1994) 11

Reynoldsville Casket Co. v. Hyde, 514 U.S. 749 (1995) 12

Welch v. Henry, 305 U.S. 134 (1934) 10

W.R. Grace & Co.– Conn. v. State of Washington, Department of Revenue, 973 P.2d 1011, *cert. denied*, ___ U.S. ___, 120 S.Ct. 371 (1999) 12

TABLE OF AUTHORITIES – Continued

Page

STATUTES

28 U.S.C. § 1257(a) 1

42 Pa. C.S. § 761 2

72 P.S. § 4821 ..... 2, 3, 4, 6

72 P.S. § 5566b 5, 15, 16, 17

OPINIONS

The Opinion and Judgment of the Supreme Court of Pennsylvania issued June 1, 2000, and the dissent thereto, (Pet. App. 1-App. 35) will be reported at 757 A.2d 338.

The Opinion and Order of the Supreme Court of Pennsylvania issued April 7, 1998 (Pet. App. 36-App. 48) are not reported in the Atlantic Reporter (Second). They are unofficially reported at *Annenberg, et al. v. The Commonwealth,* 2000 WL 704980.

JURISDICTION

The Opinions and Judgment of the Supreme Court of Pennsylvania (Pet. App. 1-App.35) were filed on June 1, 2000. The petition for writ of certiorari was filed on August 30, 2000. This Court has jurisdiction in its discretion to review a Judgment of the Supreme Court of Pennsylvania pursuant to 28 U.S.C. § 1257(a).

COUNTER-STATEMENT OF CASE

On March 27, 1996, on the heels of this Court's determination in *Fulton Corp. v. Faulkner,* 516 U.S. 325 (1996), Walter H. Annenberg, as the Sole Trustee for the Trust under the Will of Moses L. Annenberg, and Walter H. and

Leonore Annenberg (collectively, "Petitioners") filed petitions for review in the nature of a complaint for declaratory and injunctive relief in the Commonwealth Court of Pennsylvania against the Commonwealth of Pennsylvania and Thomas W. Corbett, Jr., Attorney General (collectively, the "Commonwealth") and also against the Board of Commissioners of the County of Montgomery and each Commissioner in his official capacity, the Board of Assessment Appeals of the County and the County itself (collectively, the "County"). Petitioners sought a declaration that 72 P.S. § 4821 (the County's "personal property tax" hereinafter) violates the Commerce Clause of the United States Constitution and is therefore null and void insofar as it imposes a tax on Petitioner's corporate stock.

By order dated December 23, 1996, the Commonwealth Court of Pennsylvania declined to exercise original jurisdiction and transferred the case to the Court of Common Pleas of Montgomery County sitting in equity "for the development of a complete factual record."

On January 3, 1997, Petitioners petitioned the Supreme Court of Pennsylvania to exercise plenary jurisdiction, 42 Pa. C.S. § 761. On January 31, 1997, the Supreme Court of Pennsylvania granted Petitioners' petition for plenary jurisdiction limited to the issue of whether 72 P.S. § 4821 is constitutional.

Petitioners challenged the constitutionality of the exemption of certain stock from taxation contained in what has been referred to as the "stock clause" of the personal property tax. The exemption can be highlighted as follows:

> [[t]he personal property tax shall be due on] all shares of stock in any bank, corporation, association, company or limited partnership, created or formed under the laws of this Commonwealth or of the United States, or of any other state or government, **except shares of stock in any** bank, bank and trust company national banking association, savings institution, **corporation,** or limited partnership liable to a tax on its shares or a gross premiums tax, or **liable to or relieved from the capital stock or franchise tax** for State purposes under the laws of this Commonwealth . . . 72 P.S. § 4821 [emphasis added].

Shares of stock in foreign corporations which do not do business in Pennsylvania, and therefore neither pay the capital stock nor the franchise tax, were subject to the personal property tax. On the other hand, shares of stock in corporations which do business in Pennsylvania, and therefore pay the capital stock or the franchise tax, were exempt from the personal property tax. It was this exemption, and only this exemption, which served as the basis of Petitioners' challenge.

By Order dated April 7, 1998, the Supreme Court of Pennsylvania found that the exemption in the stock clause facially discriminates against interstate commerce. However, the Court directed the Court of Common Pleas of Montgomery County to conduct a hearing on the following issues: "Whether 72 P.S. § 4821 is a 'compensatory tax' as defined by *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996). If it is determined that 72 P.S. § 4821 is not a 'compensatory tax,' and that 72 P.S. § 4821 is therefore unconstitutional as it violates the Commerce Clause of

the United States Constitution, what is the appropriate remedy."

By Order dated August 17, 1998, the Supreme Court of Pennsylvania clarified its April 7, 1998 Order and directed that the evidentiary hearing before the Court of Common Pleas be limited to the following issues: "(i) the evidence regarding the compensatory tax question; (ii) legal arguments on whether the personal property tax is a compensatory tax; and (iii) legal arguments as to whether it is the exemption that is unconstitutional, as opposed to the entire tax. The issue of what the appropriate remedies would be, in the event that 72 P.S. § 4821 is found to be unconstitutional, is not to be examined at these hearings." The August 17, 1998 Order further provided that: "At the conclusion of these hearings, we direct President Judge Smyth to prepare an interim report detailing his findings of fact and conclusions of law. . . . No action is to be taken on the issue of possible remedies until further instruction is issued by this Court."

President Judge Joseph A. Smyth accordingly conducted hearings in which Petitioners, the County, and the Intervenor Counties (collectively "the Counties") participated. After the close of hearings, President Judge Smyth filed an interim report with the Supreme Court of Pennsylvania on October 7, 1998. President Judge Smyth found that the exemption contained in the stock clause was not "compensatory", concluded that the exemption was unconstitutional, but reasoned that the statute need not be struck down in its entirety. Rather, President Judge Smyth opined that the language of the statute which excluded from taxation stock subject to the capital stock or franchise tax could be severed, leaving a personal

property tax which applied to all classes of stock whether they be held in out-of-state or in-state corporations. Finally, President Judge Smyth declared that the Counties could keep the tax which had been previously collected under the stock clause. In so concluding, President Judge Smyth stated that once the unconstitutional exemption was severed from the stock clause, leaving a tax which was applicable to stock held in either out-of-state or in-state entities, a valid tax remained. Consequently, President Judge Smyth reasoned the "Counties should be permitted to retain and collect the personal property tax on stock that is not subject to the capital stock or franchise tax."

On June 1, 2000, the Supreme Court of Pennsylvania affirmed President Judge Smyth's finding that the tax scheme impermissibly discriminated against interstate commerce, and that the exemption could be severed from the stock clause. The case was remanded to the Counties to fashion a remedy. Consistent with *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, Fla. Dept. of Business Regulation*, 496 U.S. 18 (1990), the Supreme Court of Pennsylvania found that the due process clause of the Fourteenth Amendment required that the Counties fashion a backwards-looking remedy whereby those taxpayers who had paid the tax were put in the same position as those taxpayers who had been favored by the unlawful exemption. The Court emphasized that the Counties' hands were not bound in choosing what type of backward looking remedy they could employ.

The Supreme Court of Pennsylvania rejected Petitioners' contention that the one, and only, remedy to cure the discrimination is a refund. The Supreme Court of Pennsylvania found that the refund statute, 72 P.S.

§ 5566b, was inapplicable to this case. The Court emphasized that it did not conclude that Counties are not legally entitled to levy a personal property tax on corporate stock holdings. Rather, it determined that in levying the personal property tax on corporate stock holdings, the Counties are not legally entitled to grant the exemption in 72 P.S. § 4821 to stock and corporations which have a taxable nexus with Pennsylvania because doing so discriminates against interstate commerce in violation of the Commerce Clause. The tax levied by Montgomery County on the Petitioners' corporate stock holdings constituted a tax to which the County was legally entitled. It was the exemption limited to Petitioners' stock in corporations which have a taxable nexus with Pennsylvania which constituted the illegal act by Montgomery County. Montgomery County had not levied a tax to which it was not legally entitled but instead granted an illegal exemption from a tax to which it was legally entitled. The Court found that the refund statute does not therefore limit the broad range of remedies permissible under the United States Constitution to the refund of taxes collected by the Counties. It is the Supreme Court of Pennsylvania's adherence to *McKesson* which Petitioners challenge in the present Petition for Certiorari. Therefore, Petitioners attempt to foreclose the County from fashioning an appropriate remedy consistent with *McKesson*.

ARGUMENT

Petitioners broadly assert that the Supreme Court of Pennsylvania's remand of their claims to the County of Montgomery to cure the impermissible tax scheme was

improper because the only permissible remedy under state law is a refund. Petitioners' argument ignores the clear principle of law first enunciated by this Court in *McKesson*, that a taxing authority has flexibility in curing an impermissibly discriminatory tax. Petitioner is asking this Court to simply abandon the flexibility it provided to taxing authorities in *McKesson* and which it has applied in numerous post-*McKesson* cases. The decision of the Supreme Court of Pennsylvania follows *McKesson, and* does not conflict with any decision of this Court. Therefore, further review is not warranted.

A. THE SUPREME COURT OF PENNSYLVANIA'S RULING THAT RESPONDENTS ARE RESPONSIBLE FOR PROVIDING PETITIONERS WITH A REMEDY CONSISTENT WITH *McKESSON* DOES NOT VIOLATE THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT.

Petitioners in their Petition for Writ of Certiorari assert that the payment of refunds is the only available remedy. According to Petitioners, this result is inevitable because the Supreme Court of Pennsylvania found that the portion of the stock clause which excludes from the personal property tax stock held in companies which are subject to the Pennsylvania Capital Stock and Franchise Tax operated in a manner that discriminated against interstate commerce. If the Petitioners are correct, then this Court must overturn the well-settled principle that a taxing authority must be given flexibility in curing an

impermissibly discriminatory tax, a principle which was first enunciated in *McKesson*.

In *McKesson*, the Florida Supreme Court held that Florida's Liquor Excise Tax unconstitutionally discriminated against interstate commerce because it provided preferences for distributors of certain local products. However, the Florida court declared that its ruling would be purely prospective, and denied the taxpayers any retrospective remedy.

This Court reversed the Florida Supreme Court and held that the Due Process Clause of the Fourteenth Amendment compelled Florida to fashion a backward-looking remedy whereby those who had paid the tax were put in the same position as those taxpayers who had been favored by the unlawful exemption. *McKesson*, 496 U.S. at 43. Significantly, this Court did not impose a remedy on Florida but, instead, enabled Florida the flexibility to cure the discrimination "through any form of relief, ranging from a refund of the excess taxes paid by Petitioner to an offsetting charge to previously favored distributors." *Id.* at 51.

In this case, the Supreme Court of Pennsylvania recognized that it was reviewing "a nearly identical situation" to *McKesson*. Pet. App. 23. Therefore, the Supreme Court of Pennsylvania followed *McKesson* by shifting the responsibility to the taxing authority to fashion a remedy to cure the discriminatory tax. Pet. App. 35.

Petitioners admit that *McKesson* stands for the "general proposition" that the taxing authority retains some "flexibility" in crafting the appropriate "meaningful

backward-looking" relief. Pet. 10. Despite their admission, however, Petitioners still argue that Respondents herein should be totally denied the opportunity of fashioning a remedy.

In *McKesson*, this Court indicated that there were special circumstances where refunds would be the only possible remedy. According to this Court, if the Liquor Excise Tax at issue in *McKesson* had been declared invalid "either because (other than its discriminatory nature) it was beyond the State's power to impose" or "because the taxpayers were absolutely immune from the tax," refunds would be the only way of curing the invalidity of the tax. *Id.* at 39. However, because the tax scheme in *McKesson* was not invalidated in its entirety by the Florida Court, but rather was held to be unconstitutional only insofar as it operated in a manner that discriminated against interstate commerce, this Court held that Florida retained flexibility in responding to this determination. *Id.* at 40-41. This case is nearly identical to *McKesson* in that the tax scheme was not invalidated in its entirety by the Supreme Court of Pennsylvania, but was found unconstitutional only insofar as it operated in a manner that discriminated against interstate commerce. Pet. App. 15-16. Thus, the taxing authority in Pennsylvania must, like the taxing authority in Florida, retain flexibility in responding to the discriminatory tax scheme.

Accordingly, Petitioners' argument that the taxing authority should not retain flexibility in fashioning a remedy falls outside the general proposition of *McKesson* and is therefore misplaced.

Petitioners also argue that even if Respondents are given the opportunity to fashion a remedy as required by *McKesson*, it will be impossible for Respondents to do so without violating constitutional limitations.[1]

Petitioners are putting the cart before the horse. They have filed a Petition which seeks to have this Court overturn *McKesson* and deny Respondents an opportunity to fashion a remedy. By their argument, Petitioners have attempted to bring the remedy process outlined in *McKesson* and followed by the Supreme Court of Pennsylvania to a grinding halt. They cannot at the same time challenge some hypothetical remedy which has not yet been proposed. They are premature at best. If the Respondents are subsequently allowed to proceed in accordance

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[1] For example, Petitioners allege that the taxing authority is precluded from retroactively imposing the personal property tax and cite *Commonwealth v. Budd Co.*, 108 A.2d 563 (Pa. 1954), *appeal dismissed*, 349 U.S. 935 (1955) in support thereof. In *Budd*, the Supreme Court of Pennsylvania held unconstitutional a 1947 corporate net income tax act which prohibited the deduction from 1944 net income of carry-back losses suffered in 1946 because it retroactively changed the law in calculating 1944 net income. Petitioners' argument is misplaced. First, the continued vitality of *Budd* is questionable. *Garofolo, et al. v. Commonwealth*, 648 A.2d 1329, 1332 (Pa. Cmwlth), *appeal dismissed*, 659 A.2d 561 (1994). See also *Fisher Controls Co., Inc. v. Commonwealth*, 381 A.2d 1253 (Pa. 1977). Moreover, as was the case in *Garofolo*, *Budd* is clearly distinguishable from the facts of this case because the 1947 corporate net income tax act changed the state tax base for the 1944 tax year in violation of *Welch v. Henry*, 305 U.S. 134 (1934). That is not the case here. Under Pennsylvania's personal property tax statute, all taxpayers are required to pay the exact same rate on all shares of stock and that rate is consistent for all years at issue in this case.

with *McKesson* and to fashion a remedy, the Petitioners will then have an opportunity (if they then desire) to challenge the remedy based on real, rather than hypothetical facts.

B. THE SUPREME COURT OF PENNSYLVANIA CORRECTLY HELD THAT *McKESSON* PROVIDES A TAXING AUTHORITY WITH FLEXIBILITY IN CURING A DISCRIMINATORY TAX SCHEME.

As discussed earlier, Petitioners admit that *McKesson* stands for the "general proposition" that the taxing authority retains some "flexibility" in crafting the appropriate "meaningful backward-looking" relief. Pet. 10

Nevertheless, Petitioners argue that the post-*McKesson* decisions in *Reich v. Collins*, 513 U.S. 106 (1994) and *Newsweek, Inc. v. Fla. Dept. of Revenue, et al.*, 522 U.S. 442 (1998),[2] abandon that very flexibility that this Court provided to taxing authorities in *McKesson*.[3]

An identical argument to the Petitioners was recently raised, and rejected, in a similar case from Washington

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[2] Both *Reich* and *Newsweek* are factually distinguishable from the instant case because in both of these cases, the taxpayers would have had no remedy if the respective state court decisions were affirmed. In this case, the Supreme Court of Pennsylvania has already recognized that, consistent with *McKesson*, the taxpayers are entitled to "meaningful backward-looking" relief.

[3] The Court expressly noted that its approach in *McKesson* regarding retrospective relief "is rooted firmly in precedent dating back to at least early [20th] century." *McKesson*, 496 U.S. at 32.

State. *W.R. Grace & Co. – Conn. v. State of Washington, Department of Revenue*, 973 P.2d 1011, *cert. denied*, ___ U.S. ___, 120 S. Ct. 371 (1999). In *W.R. Grace*, taxpayers brought an action alleging that the Washington Department of Revenue was unconstitutionally seeking to collect business and occupation taxes on interstate manufacturers and sellers. The Washington Supreme Court held, *inter alia*, that tax credits provided in a remedial taxing statute were an appropriate remedy where a taxing scheme was held to be unconstitutional. However, the taxpayers argued that the 1987 Credit Law, as an exclusive remedy, did not meet the requirements of federal due process. The Washington Supreme Court noted that at oral argument, taxpayers asserted that *Reich*, *Newsweek* and *Dryden v. Madison County*, 522 U.S. 1145 (1998), an opinion which vacated a Florida Supreme Court decision and remanded in light of *Newsweek*, were dispositive of the *Grace* case, suggesting the United States Supreme Court has retreated from the approach announced in *McKesson*. The Washington Supreme Court rejected this argument and stated that these cases, read together with *Associated Indus. v. Lohman*, 511 U.S. 641 (1994), and *Reynoldsville Casket Co. v. Hyde*, 514 U.S. 749 (1995), "do not indicate the Supreme Court has abandoned the 'flexibility' enunciated in *McKesson* . . . " *W.R. Grace*, 973 P.2d at 1020 n.12.

Likewise, the Supreme Court of Pennsylvania's decision acknowledges the continued vitality of *McKesson*, and its opinion is completely consistent with *McKesson* in recognizing that a refund is not the only possible remedy to cure a discriminatory tax.

As *McKesson* holds, a taxing authority that is found to have imposed an impermissibly discriminatory tax retains flexibility in responding to this determination and may cure the impermissible discrimination, *inter alia*, by: (1) refunding the difference between the tax the taxpayer paid and the tax that the taxpayer would have paid had the taxpayer been assessed in the same manner as others in taxpayer's class; (2) to the extent consistent with other constitutional restrictions, retroactively assessing other members of the taxpayer's class in the same manner that the taxpayer had been assessed; *or* (3) using a combination of a partial refund to the taxpayer and a partial retroactive assessment of a tax increase on other members of the taxpayer's class, so long as the resultant tax assessed during the contested tax period reflects a scheme that does not discriminate against interstate commerce. Each of these alone could satisfy the requirements of federal due process.

Therefore, it is clear that the taxing authority has the flexibility and sole responsibility under *McKesson* to fashion a remedy that is consistent with federal due process, making Petitioners' argument that a refund is the only possible remedy here simply premature. As this Court stated in *McKesson*:

> Because we do not know whether the state will choose in this case to assess and collect back taxes from previously favored distributors, we need not decide whether this choice would violate due process by unduly interfering with settled expectations. Should the state choose this remedial alternative, the state's effort to collect back taxes from previously favored distributors may not be perfectly successful. Some of these

> distributors, for example, may no longer be in business. But a good faith effort to administer and enforce such a retroactive assessment likely would constitute adequate relief, to the same extent that a tax scheme would not violate the commerce clause merely because tax collectors inadvertently missed a few in-state taxpayers. *McKesson*, 496 U.S. at 41 n.23.

Subsequent to *McKesson*, this Court has time and time again reinforced the flexibility that a taxing authority has in responding to an impermissible tax scheme. In *Associated Indus. v. Lohman*, 511 U.S. 641 (1994), this Court stated:

> That we have declared the tax scheme impermissibly discriminatory in some localities does not in itself dictate the relief that the State must provide. As we noted in [*McKesson*], a "state found to have imposed an impermissibly discriminatory tax retains flexibility in responding to this determination." . . . [T]he Due Process Clause would demand only that, "to cure the illegality of the tax as originally imposed, the State must ultimately collect the tax for the contested tax period that in no respect impermissibly discriminates against interstate commerce." *Id.*, at 44, n.27 . . . The methods best adapted to achieving equal treatment in this case, whether partial or complete refunds or other measures, are similarly matters properly left for determination on remand. *Lohman*, 511 U.S. at 656.

In *Harper v. Virginia Department of Taxation*, 509 U.S. 86 (1993), retired federal employees sought a refund of

certain Virginia state taxes, based on a retroactive application of this Court's decision in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989). Although this Court agreed that *Davis* should apply retroactively to the tax years at issue in Petitioners' refund action, the Court refused to enter Judgment for the Petitioners "because federal law does not necessarily entitle them to a refund." *Harper*, 509 U.S. at 100. Thus, according to *Harper*, federal law does not necessarily mandate the refund of a tax found to be impermissibly discriminatory, and states retain flexibility to craft a remedy which satisfies federal due process. *Harper*, 509 U.S. at 100. "Under the Due Process Clause, U.S. Const., Amdt. 14, § 1, 'a State found to have imposed an impermissibly discriminatory tax retains flexibility in responding to this determination.' " *Id.* (citing to *McKesson*, 496 U.S. at 39-40). Therefore, this Court held that, "Virginia 'is free to choose which form of relief it will provide, so long as that relief satisfies the minimum federal requirements we have outlined'." *Harper*, 509 U.S. at 102 (citing *McKesson*, 496 U.S. at 51-52).

In *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), the case relied upon by Petitioners, this Court found that North Carolina's intangibles tax facially discriminated against interstate commerce; however, this Court did not impose a remedy upon North Carolina. Citing favorably to *McKesson*, this Court held that North Carolina retained flexibility in responding to the impermissibly discriminatory tax. *Id.* at 346.

Petitioners, however, ignore the well-settled principle of federal law set forth in *McKesson* and argue that because Pennsylvania has a statute which provides for a tax refund in certain circumstances, 72 P.S. § 5566b, this

Court must abandon the flexibility that a taxing authority is provided in order to cure a discriminatory tax scheme. In other words, Petitioners are asking this Court to ignore the Constitution's Supremacy Clause, U.S. Const., art. VI, cl. 2, to rule that Pennsylvania's refund statute, which as discussed below is not even applicable under the facts of this case, trumps well-established federal law.

The Petitioners' argument regarding the refund statute is misplaced because they ignore the fact that the tax at issue in this case is itself not unconstitutional. As the Supreme Court of Pennsylvania noted, "[i]n its simplest terms, Section 5566b [only] provides a mechanism for the refund of taxes 'to which the political subdivision is not legally entitled.' " Pet. App. 29. As a majority of the Supreme Court of Pennsylvania observed, Montgomery County did not levy a tax to which it was not legally entitled, but instead, granted an illegal exemption from a tax to which it was legally entitled.[4] Thus, consistent with this ruling, and *McKesson*, the Supreme Court of Pennsylvania correctly noted that 72 P.S. § 5566b does not limit the broad range of permissible remedies to only a refund of taxes that were collected by the counties. In addition to the majority opinion, even Justice Cappy, in his Concurring and Dissenting Opinion, on which Petitioners expressly rely, points out that a refund such as that sought by Petitioners is not the only possible remedy:

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[4] When the Court severed the exclusionary language in the stock clause which renders the stock clause unconstitutional, it left intact the County's ability to levy a personal property tax on corporate stock generally.

> I believe that the statutory requirement of providing a "refund" [original quotation] could be met in at least two fashions. One way would be to provide an immediate, lump sum payment of money. Another way of satisfying the dictates of 72 P.S. § 5566b would be to allow the counties to compensate the affected taxpayers by granting them a credit equal to the amount of taxes illegally collected pursuant to the discriminatory stock clause. This credit could be utilized to offset any taxes owed by that taxpayer to the county, whether those taxes be owed pursuant to the stock clause of the personal property tax or any other tax. Pet. App. 33 n.2.

Therefore, the flexibility provided to the taxing authorities by the Supreme Court of Pennsylvania is consistent with *McKesson* and the well-settled principles of federal law that Petitioners now ask this Court to overturn.

CONCLUSION

For all of the foregoing reasons, the petition for writ of certiorari submitted by Petitioners Walter H. Annenberg, individually and as Sole Trustee of the Trust Under Will of Moses L. Annenberg, and Leonore Annenberg should be denied.

Respectfully submitted,

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